FILED
JUN 26 1990
CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

No. 0-196 / 89-601

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PAUL S. KURTZ,

Plaintiff-Appellant/Cross-Appellee,

vs.

HENRY J. TREPP,

Defendant-Appellee/Cross-Appellant.

Appeal from the Iowa District Court for Black Hawk County, Roger F. Peterson, Judge.

The district court awarded Kurtz damages resulting from Trepp's conversion of the real estate in 1975. Kurtz appeals contending that the evidence supported a finding that Trepp breached his fiduciary duty to Kurtz, thereby causing Kurtz damages equal to his loss of investment from 1975 to the present day. Kurtz also claims that the evidence supported an award of punitive damages. **AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.**

Michael W. Rickert and Robert W. Thompson, Reinbeck, for appellant.

Bruce B. Zager, Waterloo, for appellee.

Heard by Oxberger, C.J., and Hayden and Sackett, JJ.

OXBERGER, C.J.

The central issue in the present case concerns the proper measure of damages upon a finding that a corporate director has breached his fiduciary duty to other shareholders and the corporation. Numerous issues have been presented by both parties, and we have considered all of them, but we address only those issues which are dispositive of the appeal. The present case was previously before us in Kurtz v. Trepp, 375 N.W.2d 280 (Iowa App. 1985).

In 1971, the plaintiff, Paul Kurtz, and the defendant, Henry Trepp, formed a partnership in order to purchase potential investment property in the Waterloo area. The parties agreed that they would jointly own and manage the property. Kurtz argues that he contributed a $3,000 real estate commission, and Trepp claims that he assigned an interest in other property he owned. The parties incorporated under the name of T & K Lands, Inc., with Kurtz and Trepp listed as directors, in July of 1971.

Beginning in 1973, a dispute arose between the parties concerning Kurtz's management style. Trepp alleged that Kurtz had failed to properly maintain the corporate books and provide an accurate accounting and that consequently the contract payments to the loaning bank were in arrears. Kurtz had additionally failed to properly file necessary reports with the secretary of state, and the articles of

incorporation were allowed to lapse. As a result, Trepp took over the day-to-day management of the property.

From 1973 to 1975, the parties attempted to resolve their differences, but without success. Kurtz proposed on numerous occasions that Trepp either buy him out or liquidate the property and divide the profits. Kurtz ultimately hired attorney George Lindeman to assist him. From that point, there were no other direct communications between the parties other than through their respective counsel. Kurtz did provide Trepp with a worksheet which he represented as an accounting, but Trepp claimed it was unsatisfactory. On January 10, 1975, Trepp's attorney wrote to Lindeman stating that due to Kurtz's failure Trepp had to protect his own interests and felt no further obligation towards Kurtz.

Rather than institute a lawsuit, however, Trepp in 1975 called and conducted a stockholder's meeting without notice to or attendance by Kurtz. Trepp elected himself sole director, issued himself stock, and assigned all title in the real estate to himself. Trepp additionally applied for reinstatement of the articles of incorporation and changed the name of the corporation to Sunny Hills, Ltd.

In 1981, Kurtz discovered that Trepp had conveyed the property. Kurtz then filed an action against Trepp claiming damages for Trepp's actions beginning in 1975. Trepp counter-claimed that Kurtz had failed to repay a personal loan. The district court granted summary judgment

in favor of Trepp without addressing Trepp's claim that the statute of limitations had run. On appeal, we held that Trepp fraudulently concealed his actions, thereby breaching his fiduciary duty to Kurtz, and thereby tolled the statute of limitations until Kurtz discovered the cause of action in 1981. Kurtz v. Trepp, 375 N.W.2d 280, 284 (Iowa App. 1985).

On remand, following a bench trial, the district court found in favor of Kurtz on his claim and in favor of Trepp on his counterclaim. The court concluded that Trepp converted Kurtz's interest in the corporation by issuing stock to Trepp only. The court determined the damages were the fair market value of the stock at the time of conversion. The stock's value was equal to the value of real estate. The court awarded Kurtz half the value of real estate plus interest at the rate of ten percent per year. The court further found that Kurtz had not repaid Trepp $2500, and therefore entered judgment against Kurtz for $2500 plus interest at the rate of ten percent per year. The parties agreed to the interest rate. Kurtz has appealed and Trepp cross-appealed.

Because the present case was an action tried at law, our review is for the correction of errors at law only. Iowa R. App. P. 4. We are bound by the trial court's findings of fact if supported by substantial evidence. Iowa R. App. P. 14(f)(1).

Kurtz first contends that the trial court erred in awarding damages based on conversion due to Trepp's wrongful taking of the investment property. Kurtz argues that he did not lose his interest in the property at the time Trepp issued stock to himself. Rather, Kurtz maintains because of Trepp's fraudulent concealment and breach of fiduciary duty, the amount of damages should be measured pursuant to the benefit of the bargain concept previously approved by our courts. Kurtz requests that he be awarded not only a one-half interest in the investment property at its present value, but one-half of all net income from the property from 1975 to the present. We agree.

Our courts have long recognized that officers and directors of corporations are trustees of the corporate assets and occupy a fiduciary relation to the corporation and stockholders and are required to act in the utmost good faith. Schildberg Rock Products Co. v. Brooks, 258 Iowa 759, 766, 140 N.W.2d 132, 136 (1966). A director will therefore not be permitted to derive any secret advantages from such trust. First Nat. Bank v. One Craig Place, Ltd., 303 N.W.2d 688, 695 (Iowa 1981), citing Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 402-03, 107 N.W. 629, 632 (1906). A director must therefore act at all times in the best interests of the corporation and must use such care as an ordinary prudent person in a like position would use

under similar circumstances. Iowa Code § 496A.34 (1989).[1] We have also previously recognized that one party cannot unilaterally end the fiduciary relationship of a partnership to the detriment of the other party. Kurtz v. Trepp, 375 N.W.2d 280, 283 (Iowa App. 1985).

Iowa Code section 496A.34 (1989)[2] sets forth those circumstances under which a director's actions will not be considered self-dealing. Pursuant to section 496A.34, a conflict of interest transaction will not be voidable by the corporation solely because of a director's interest if (a) the material facts were disclosed or known to the board or approved by it; (b) the material facts were known to the shareholders and they authorized the action; or (c) the transaction was fair to the corporation.

In the present case, we have previously determined that Trepp's actions were fraudulent and were a breach of his fiduciary duty to Kurtz. See Kurtz v. Trepp, 375 N.W.2d 280 (Iowa App. 1985). By transferring title of the property into his own name and out of the corporation, by issuing a share of stock, and by changing the name of the corporation, all without a meeting of the board of directors, Trepp was engaging in self-dealing which

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1. As of December 31, 1989, Chapter 496A, Business Corporation Act, was repealed and renumbered Chapter 490. The language cited may now be found in section 490.830(1)(b).

2. Now reclassified as Iowa Code section 590.831(1)(a-c).

resulted in losses to Kurtz without his authority or approval, and pursuant to section 496A.34, his acts were voidable. As such, Kurtz is entitled to receive compensation for such unauthorized acts.

In Midwest Management Corp. v. Stephens, 353 N.W.2d 76, 81 (Iowa 1984), the Iowa Supreme Court recognized that when a party has been deceived into investing in a corporation, the measure of damages is the "loss of the investment less any value accruing to the [investor] from it." The measure of damages is the same whether the underlying theory of liability is fraud or breach of fiduciary duty. First National Bank v. One Craig Place, Ltd., 303 N.W.2d 688, 694 (Iowa 1981); Charles v. Epperson & Co., 258 Iowa 409, 430, 137 N.W.2d 605, 617 (1965); Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 243 Iowa 1007, 13, 51 N.W.2d 174, 191 (1952).

In the present case, we believe the benefit of the bargain rule, rather than conversion, is the proper measure of damages. We first note, however, that our emphasis should not be on the rental properties, but in the stock issued by Trepp for the corporation in which title to the rental properties is placed. In order to determine the value of the stock, we must first determine what is the present value of the rental properties.

We disagree with the district court's valuation of Kurtz's interest in the rental properties. Proceeding on the theory of conversion, the trial court held that Kurtz's

interest in the partnership as of January 10, 1975, was $10,782.48, less payments made by Trepp to satisfy the bank concerning past due amounts, for a total interest of $8,418.29. Applying the benefit of the bargain theory, we believe the more proper measure of damages is to grant Kurtz an undivided one-half interest in the stock based on the present value of the rental properties. In 1975, Kurtz had the property appraised at $72,500.

Evidence introduced at trial reveals that from 1975 to 1987 Trepp received over $57,000 in gross rental income from the property in question. However, the record also reveals that numerous expenses were incurred in maintaining the properties. Upon deduction of expenses, net rental income amounted to $24,524.14. Applying the benefit of the bargain rule, we believe Kurtz is entitled to a one-half interest in the net rental profits accumulated since 1975 to the present, with interest set at 10% per year.

In this case, Trepp has made much of the numerous errors Kurtz made in his attempts to manage the property. While such acts were admittedly in bad judgment and in error, we do not find such acts rising to the level of a breach of fiduciary duty so as to invoke the clean hands doctrine, as Trepp suggests. Kurtz was acting as a manager, not a director, of the rental properties pursuant to the contract between the parties. While Kurtz admitted that his accounting practices were akin to a disaster and that on several occasions he reimbursed himself for

expenses incurred while manager, we do not believe that Kurtz's actions were so egregious as to come within the ambits of section 496A.34 regarding self-dealing.

Kurtz additionally argues that the trial court erred in refusing to award punitive damages. We disagree. Punitive damages are always discretionary and are not a matter of right. Berryhill v. Hatt, 428 N.W.2d 647, 656 (Iowa 1988); Rowen v. LeMars Mut. Ins. Co. of Iowa, 282 N.W.2d 639, 661 (Iowa 1979). Punitive damages are awarded as punishment and a deterrent to other wrongdoers. Lola v. Peoples Bank & Trust Co., 420 N.W.2d 804, 807 (Iowa 1988). Punitive damages may be awarded when a defendant acts maliciously. Id. Malice may be actual or express, such as personal spite or hatred, or implied, such as when a defendant acts illegally, improperly, or in reckless disregard of another's rights. Klooster v. North Iowa State Bank, 404 N.W.2d 564, 572 (Iowa 1987).

While Trepp's conduct was wrongful, we do not believe that his actions were so malicious as to justify an award of punitive damages. Trepp took over the rental property, not for any personal motive against Kurtz, but to save the property from going into default and foreclosure. The bank had been demanding an accounting and had sent a letter stating that unless payments were caught up, foreclosure proceedings would be initiated. Trepp on several occasions did attempt to negotiate with Kurtz regarding the overdue accounting, but did not receive what he considered to be an

adequate response. Though his actions in taking the property by unilateral action were in error, we do not believe Trepp had malicious intent when taking the property. We therefore find that the trial court was correct in refusing to award punitive damages.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

Hayden, J., concurs; Sackett, J., concurs in part and dissents in part.

SACKETT, J. (concurring in part and dissenting in part)

I concur in part and dissent in part. I would affirm the trial court in total.